RECORD AND BRIEFS

JUN - 6 2016

No. 15-649

IN THE
Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,

Petitioners,

v.

JEVIC HOLDING CORP., *et al.*,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

SUPPLEMENTAL BRIEF

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June 6, 2016

TABLE OF CONTENTS

Page

INTRODUCTION 1

ARGUMENT 1

I. The Alleged Circuit Conflict Is Illusory. 1

II. This Case Is Not An Appropriate Vehicle For Addressing The Question Presented. 4

III. The Decision Below Is Correct. 6

CONCLUSION 12

SUPPLEMENTAL APPENDIX CONTENTS

Brief of Appellants & Joint Appendix Vol. I,
U.S. Court of Appeals for the Third Circuit,
July 8, 2014 (excerpts) 1a

Brief of the United States as Amicus
Curiae Supporting Reversal,
U.S. Court of Appeals for the Third Circuit,
August 14, 2014 (excerpt) 7a

Transcript of Oral Argument,
U.S. Court of Appeals for the Third Circuit,
January 14, 2015 ..... 10a

TABLE OF AUTHORITIES

Page(s)

Cases

Chevron U.S.A. Inc. v. NRDC, Inc.,
467 U.S. 837 (1984) 4

In re AWECO, Inc.,
725 F.3d 293 (5th Cir. 1984) 1, 2, 3, 4, 5

In re Continental Airlines,
91 F.3d 553 (3d Cir. 1996) (*en banc*) 6

In re Iridium Operating LLC,
478 F.3d 452 (2d Cir. 2007) 1, 2, 3, 4, 5, 8

In re Metromedia Fiber Network, Inc.,
416 F.3d 136 (2d Cir. 2005) 6

Martin v. Wilks,
490 U.S. 755 (1989) 10

Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson,
390 U.S. 414 (1968) 7

Seminole Tribe of Fla. v. Florida,
517 U.S. 44 (1996) 2

Statutes

11 U.S.C. § 103(a) 7

11 U.S.C. § 1129 7

11 U.S.C. § 1129(b)(2)(B)(ii) 7

INTRODUCTION

It is no surprise that the United States has recommended a grant in this case, given that the United States actively supported petitioners in the proceedings below. In the bankruptcy court, the United States Trustee unsuccessfully objected to the proposed settlement on the ground that it violated the Bankruptcy Code's priority system. *See* U.S. Trustee Objection [Bankr. D. Del. No. 08-11006 Dkt. 1389] (7/25/12). And in the Third Circuit, the United States filed an *amicus curiae* brief and participated in oral argument to make the same point. Br. of U.S. as *Amicus Curiae* Supporting Reversal (8/14/14), Supp. App. 7-9a (excerpt); Tr. of CA3 Argument, Supp. App. 24-34a. The United States' decision to continue supporting petitioners in this Court does not make the case any more worthy of review.

ARGUMENT

I. The Alleged Circuit Conflict Is Illusory.

The petition asserts that this Court's review is warranted to resolve "a square and acknowledged conflict among the circuits" on whether the Code's priority system governs bankruptcy *settlements* as well as bankruptcy *plans*. Pet. 15 (capitalization modified). As respondents explained in their opposition brief, that alleged conflict is illusory, and rests entirely on a single sentence of *dicta* from a 1984 Fifth Circuit opinion, *See* Opp. 12-13 (citing *In re AWECO, Inc.*, 725 F.3d 293, 298 (5th Cir. 1984)). In the thirty-two years since *AWECO* was decided, the issue presented in the petition has reached the appellate level exactly twice: first in *In re Iridium Operating LLC*, 478 F.3d 452, 463-64 (2d Cir. 2007), and now in this case, *see* Pet. App. 17-21a. And both

those cases resolved that issue the same way: by holding that the Code's priority system does not by its terms govern bankruptcy settlements, but that compliance with the system is nonetheless a critical factor in assessing such a settlement. *See Iridium*, 478 F.3d at 455; Pet. App. 20a.

The United States does not take issue with respondents' description of *AWECO*, but simply asserts without explanation that *AWECO* "held" its sentence of *dicta*. U.S. Br. 19 (citing *AWECO*, 725 F.2d at 298). That assertion displays a fundamental misunderstanding of the difference between a court's holding (which is binding) and its *dicta* (which is not). A court's holding "is not only the result but also those portions of the opinion *necessary* to that result." *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 67 (1996) (emphasis added).

As respondents explained in their opposition brief, the sentence from *AWECO* on which petitioners and the United States rely is *dicta*, because the Fifth Circuit in that case vacated the bankruptcy court's decision on the ground that the court had abused its discretion by "bless[ing] the settlement without sufficient factual information to determine if the settlement was fair and equitable." 725 F.2d at 300; *see also id.* at 299 ("An approval of a compromise, absent a sufficient factual foundation, inherently constitutes an abuse of discretion."). *See* Opp. 12-13. The Fifth Circuit's discussion of the legal standard to be applied by the bankruptcy court on remand was neither "the result" nor "necessary to th[e] result" in that case. *Seminole Tribe*, 517 U.S. at 67.

Moreover, the *AWECO dicta* is based on the premise that the settlement there was a step on the path to a plan of reorganization, which concededly would be governed by the Code's priority system. *See* 725 F.2d at 298. Obviously, a pre-plan settlement cannot be used to circumvent the legal constraints on plan confirmation. But that point has no bearing where—as the bankruptcy court found here, *see* Pet. App. 58a, and neither petitioners nor the United States contests—no plan could ever be confirmed, and the proposed settlement would effectively conclude the case.[1] Even assuming that *AWECO* established a bright-line legal rule in the context of settlements on the path to an eventual plan, that rule would have no bearing in the very different context of settlements where no plan is feasible. *See* Opp. 15.

The United States insists, however, that there is a circuit conflict here because "the Second Circuit in [*Iridium*] rejected as 'too rigid' the rule adopted by the Fifth Circuit" in *AWECO*, and the Third Circuit below "stated that it 'agreed with the Second Circuit's approach in *Iridium*.'" U.S. Br. at 19-20 (quoting 478 F.3d at 464 and Pet. App. 19a). But neither the Second nor the Third Circuit had any reason to distinguish *AWECO*'s *dicta* from its holding. And neither the Second nor the Third

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[1] Insofar as the United States suggests in passing that the Bankruptcy Code does not authorize the "structured dismissal" of a Chapter 11 case, *see* U.S. Br. 15, that issue is not presented by the petition, which is limited to the question "[w]hether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme." Pet. i; *see generally* Opp. 23 n.4.

Circuit remotely suggested that *AWECO* was wrongly decided; to the contrary, those cases simply noted that the single sentence on which petitioners and the United States rely sweeps more broadly than it should. The Fifth Circuit has not revisited that sentence in the thirty-two years since *AWECO* was decided, and there is thus no way to know how that court would respond to that criticism. Unless this Court is to abandon the longstanding rule that it "reviews judgments, not opinions," *Chevron U.S.A. Inc. v. NRDC, Inc.*, 467 U.S. 837, 842 (1984), and starts granting review to flyspeck lower-court opinions, there is no reason to grant the petition to address the Second and Third Circuit's disagreement with a single sentence of *dicta* penned by the Fifth Circuit thirty-two years ago.

II. This Case Is Not An Appropriate Vehicle For Addressing The Question Presented.

In any event, as respondents further explained in their opposition brief, this case does not present an appropriate vehicle for addressing the alleged circuit conflict because petitioners never told the Third Circuit that they disagreed with the Second Circuit's legal analysis in *Iridium* or asked the Third Circuit to reject that analysis. *See* Opp. 24-25. To the contrary, as the Third Circuit emphasized, petitioners cited *Iridium* "throughout their briefs and never quarrel[led] with it." Pet. App. 19a.

Even cursory review of the briefing below shows that petitioners and the United States made a tactical choice: they refrained from asking the Third Circuit to adopt *AWECO*'s bright-line rule, as opposed to *Iridium*'s slightly relaxed form of that rule. That reticence is understandable: the *AWECO*

dicta has no basis in the Code's text or structure. Thus, appellants and the United States cited *AWECO* and *Iridium* in tandem in their briefs, without purporting to draw any distinction between the legal standard applied in the two cases or suggesting that the legal standard applied in *Iridium* was wrong. *See* Petrs.' CA3 Br. 26, 35, Supp. App. 1-6a (excerpts); U.S. CA3 *Amicus* Br. 21, Supp. App. 7-9a (excerpt). Indeed, even the dissenting judge below accepted and applied the *Iridium* standard. *See* Pet. App. 24a (Scirica, J., dissenting).

The United States' current assertion that "petitioners ... argued *in the alternative* that they would prevail even under the *Iridium* standard," U.S. Br. 21 (emphasis added), is demonstrably incorrect. An alternative argument proceeds along the following lines: "We advocate legal position X. In the alternative, if the court does not accept X, we advocate legal position Y." As noted above, neither petitioners nor the United States drew any such distinction between *AWECO* and *Iridium* in the Third Circuit, but instead cited both cases in tandem and (as the Third Circuit emphasized) "never quarrel[led] with" *Iridium*. Pet. App. 19a.

If petitioners and the United States wanted the Third Circuit to reject the *Iridium* standard, they had an obligation to ask the Third Circuit to do so. They never did. To the contrary, even in their petition for rehearing *en banc*, petitioners argued only that the panel had *misapplied* the *Iridium* standard. *See* Opp. App. 13-15a. For petitioners and the United States now to argue that the Third Circuit erred by following *Iridium* is nothing but sandbagging. Certainly, this Court, which has

plenary discretion over the cases it chooses, should not grant review to resolve an alleged circuit conflict where, as here, petitioners "never quarrel[led] with," Pet. App. 19a, but rather embraced, the very legal standard they now challenge.

In addition, this case presents a particularly poor vehicle for addressing the question presented because the case is equitably moot. *See, e.g.*, *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 144 (2d Cir. 2005); *In re Continental Airlines*, 91 F.3d 553, 559-60 (3d Cir. 1996) (*en banc*). The district court so held in the alternative, *see* Pet. App. 43a, and the Third Circuit did not reach that issue. The district court's holding was sound. The settlement agreement here has been fully consummated: the fraudulent-conveyance action was dismissed with prejudice on August 29, 2013, and all of the estate's assets thereafter were distributed to creditors. *See* Pet. App. 38-39a, 43a; CA3 JA 139-41, 170-72. Of critical importance, neither petitioners nor the United States pursued a stay to delay the implementation of the agreement pending this appeal. Pet. App. 38-39a, 43a. Accordingly, even a victory in this Court would bring petitioners no relief, and they are essentially asking this Court for an advisory opinion. At the very least, this Court should not grant review in a case in which the party seeking relief did not bother to pursue a stay to block consummation of the settlement agreement and the specter of equitable mootness thus looms.

III. The Decision Below Is Correct.

On the merits, the United States agrees with petitioners that "[t]he Court of Appeals' decision is incorrect," U.S. Br. 11 (capitalization modified)—

which, again, is unsurprising given that the United States participated below as an *amicus curiae* supporting petitioners. The United States' critique of the decision below, however, is unavailing.

The United States begins with a paean to the Bankruptcy Code's priority system, which is set forth in Section 507. *See id.* at 11-13. But respondents have never disputed the importance of that system: the only question is whether it governs *settlements* as well as *plans*. The United States contends that the answer is to be found in a section of the Code specifying that "the provisions of Chapter 5 (which includes Section 507) apply to all 'case[s] under,' *inter alia*, Chapters 7 and 11." U.S. Br. 15 (quoting 11 U.S.C. § 103(a)).

But that is a *non sequitur*. To say that Section 507's priority system applies in Chapter 7 and 11 cases is not to say to *what* it applies in those cases. Section 1129 specifies that, in Chapter 11 cases, the priority system applies to *plans*. *See* 11 U.S.C. § 1129(b)(2)(B)(ii). No corresponding provision of the Code—which is, as the United States underscores, "a detailed scheme," U.S. Br. 11—purports to specify that the priority system also governs *settlements*. Accordingly, it does not. *See* Pet. App. 15-21a.

Of course, the conclusion that the Code's priority system does not govern settlements does not mean that the Code's priority system is *irrelevant* to settlements. A bankruptcy settlement must be "'fair and equitable,'" Pet. App. 11a (quoting *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968)), and ordinarily a bankruptcy settlement will not satisfy that standard unless it complies with the Code's

priority system, *see* Pet. App. 19-21a; *see also Iridium*, 478 F.3d at 464. "Although [respondents] have persuaded us to hold that the Code and the Rules do not extend the absolute priority rule to settlements in bankruptcy, we think that the policy underlying that rule—ensuring the evenhanded and predictable treatment of creditors—applies in the settlement context." Pet. App. 20a. The Third Circuit thus upheld the settlement here only upon concluding that the bankruptcy court's findings provided "'specific and credible grounds'" to justify deviation from that system. *Id.* at 21a (quoting *Iridium*, 478 F.3d at 466). In particular, the Third Circuit emphasized, the settlement was "the least bad alternative" here, "since there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order.'" *Id.* (quoting Pet. App. 58a).

The United States thus errs by accusing the Third Circuit of "approv[ing] a bankruptcy disposition that furthered the interests of the debtor and non-priority creditors *at the expense of objecting priority creditors*." U.S. Br. 13 (emphasis added). As a matter of law and logic, the settlement here could not have come "at the expense of objecting priority creditors" where those objecting creditors failed to show how rejection of the settlement would benefit them. Rejecting the settlement here simply would have left other creditors *worse* off without making petitioners any *better* off. *See id.*; *see also id.* at 21-23a. As the Third Circuit put it, "[w]e doubt that our national bankruptcy policy is quite so nihilistic." *Id.* at 23a.

The United States thus slips from reality into fantasy by asserting that "[t]he approach to settlement approved by the court below permits debtors in such cases to *collude* with sophisticated creditors to reach an agreement about the distribution of estate assets that skips less-favored creditors with priority claims over the objection of those impaired creditors." U.S. Br. 21 (emphasis added). Note that the United States does not suggest that there was any such collusion here; rather, the United States simply invokes the specter of collusion in *other* cases to suggest that the Third Circuit rendered the bankruptcy system "a free-for-all in which parties or bankruptcy courts may dispose of claims and distribute assets as they see fit." *Id.* at 15.

Nothing could be further from the truth. The Third Circuit recognized—and cautioned against—the risk of collusive settlements. *See* Pet. App. 20a ("Settlements that skip objecting creditors in distributing estate assets raise justifiable concerns about collusion among debtors, creditors, and their attorneys and other professionals."); *id.* at 20-21a ("If the 'fair and equitable' standard is to have any teeth, it must mean that bankruptcy courts cannot approve settlements and structured dismissals devised by certain creditors in order to increase their shares of the estate at the expense of other creditors."). The Third Circuit simply concluded, based on the bankruptcy court's detailed factual findings, that this is the "rare case" in which deviation from the priority system is permissible. *Id.* at 2a; *see also id.*

at 23a (deviations from priority system "likely to be justified only rarely").[2]

The United States now suggests that (1) confirmation of a Chapter 11 plan, or (2) conversion of the case to a Chapter 7 liquidation were not the only alternatives to approving the settlement. Rather, according to the United States, "[i]f a plan cannot be confirmed and conversion to Chapter 7 is not feasible, the Code provides a third option: dismissal of the bankruptcy" without a settlement, and thus without prejudice to any and all creditors pursuing the estate's fraudulent-conveyance claim on their own. U.S. Br. 17; *see also id.* at 18 ("If the bankruptcy case had simply been dismissed, petitioners could have pursued a fraudulent-conveyance action against Sun and CIT on their own behalf as creditors of Jevic."). But petitioners never proposed this alternative below, presumably because they had no interest in pursuing a long-shot fraudulent-conveyance claim.

To the contrary, petitioners asked the Third Circuit to remand the case to the bankruptcy court "with specific instruction to convert these cases to chapter 7 in light of [respondents'] concession that no chapter 11 plan is possible." Supp. App. 6a. And

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[2] Insofar as the United States suggests that the settlement improperly extinguished petitioners' claims over their objection, *see* U.S. Br. 16 (citing *Martin v. Wilks*, 490 U.S. 755, 768 (1989)), that suggestion is baseless. The settlement here involved a fraudulent-conveyance claim that belonged to the *estate*, not any individual creditor, and the Official Committee of Unsecured Creditors had the authority to litigate and, subject to court approval, settle that claim. *See* Order [Bankr. D. Del. No. 08-11006 Dkt. 118] (6/20/08).

both petitioners and the United States acknowledged below that the only realistic alternative to the settlement here was conversion to Chapter 7. *See* Pet. App. 23a (quoting concession by counsel for the U.S. Trustee that "we have to accept the fact that we are sometimes going to get a really ugly result, an economically ugly result, but it's an economically ugly result that is dictated by the provisions of the code"); Supp. App. 15a (petitioners' counsel concedes that they did not put forth any evidence that anyone would pursue the fraudulent-conveyance claim absent the settlement); *id.* at 60a ("Your Honors, we are simple folks, this case should go to a Chapter 7 trustee. We can't undo the fact that there isn't a nice landing for anyone there."). Needless to say, the United States cannot now fault the Third Circuit for not having considered an alternative that no one (including the United States) ever presented to that court. If anything, the fact that the United States is now bringing up an argument never made—and therefore forfeited—below only underscores that this case is an unsuitable vehicle for this Court's review.

At bottom, the United States' attack on the decision below is not only misguided but ironic. The United States asserts that "[g]overnment creditors like the United States have a particularly strong interest in correcting the court of appeals' erroneous decision" because that decision "creates a significant risk that debtors will collude with junior creditors to squeeze out government tax claims with higher priority." U.S. Br. 22. But the settlement here allowed the taxing authorities to recover on their priority claims, whereas they would have not have recovered under petitioners' approach, because—in the event of a conversion to Chapter 7—all the

estate's assets would have been distributed in short order to higher-priority creditors Sun Fund IV and CIT. *See* Pet. App. 58a; *id.* at 21-23a. How the United States can assert that the Third Circuit's approach imperils the very priority tax claims that it vindicated is a mystery.

If, as the United States contends, the issue presented here is "important and recurring," U.S. Br. 21 (capitalization modified), this Court can certainly allow it to percolate until presented in a case in which the party alleging a circuit conflict did not advocate the legal standard it now rejects, and in which the bogeyman of "collusion" is not merely asserted but rooted in the factual record. For now, it suffices to recognize that the Third Circuit could not have written its decision any more narrowly, and a case in which petitioners failed to show how they would benefit from a ruling in their favor is not a suitable vehicle for this Court's review.

CONCLUSION

For the foregoing reasons, and those set forth in the brief in opposition, this Court should deny the petition for writ of certiorari.

June 6, 2016

Respectfully submitted,

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SUPPLEMENTAL APPENDIX

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OFFICIAL COMMITTEE OF UNSECURED CREDITORS on behalf of the bankruptcy estates of Jevic Holding Corp., *et al.*

v.

CIT GROUP/BUSINESS CREDIT, INC., in its capacity as Agent; SUN CAPITAL PARTNERS, INC.; SUN CAPITAL PARTNERS IV, LP; SUN CAPITAL PARTNERS MANAGEMENT IV, LLC.

CASIMIR CZYZEWSKI; MELVIN L. MYERS; JEFFREY OEHLERS; ARTHUR E. PERIGARD; and DANIEL C. RICHARDS, on behalf of themselves and all others similarly situated, Appellants

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE, CIV. ACTION NOS. 13-104 and 13-105 (SLR)

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* * *

3. The Lower Courts Misapplied the Standards Under Rule 9019

* * *

The court's "scrutiny must be great when the settlement is between insiders and an overwhelming majority of creditors in interest oppose such settlement." Moreover, a settlement that entails class skipping is subject to an especially high level of scrutiny to assure fundamental fairness to non-settling creditors. Hence, in *In re AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984), the Fifth Circuit held that a pre-plan settlement of claims against the estate in exchange for estate assets was not fair and equitable in the absence of evidence that the assets remaining in the estate were sufficient to satisfy priority claimants. *Id.* at 298. Applying similar logic, the Second Circuit vacated a bankruptcy court's approval of a pre-plan settlement that distributed proceeds of an estate cause of action to a trust for the benefit of general unsecured creditors directly instead of distributing them pursuant to the Code's priority system. *In re Iridium Operating LLC*, 478 F.3d 453 (2d Cir. 2007). *See*, Point I(B), *infra*, pp. [3-6a].

Here, the Bankruptcy Court did not refer to its duty of careful examination to ensure fairness to parties that did not settle. Nor did the court subject the Settlement to stringent review despite the fact that it mandates skipping any payment to the Drivers. Instead it described the legal standard governing its review of the settlement as "not a heavy burden." JA-30. Such a limited review falls short of the "careful

examination" mandated by *Nutraquest* and disregards the interests of "other persons," namely, the Drivers, Jevic's largest creditor constituency. *In re Foster Mortgage Corp.*, 68 F.3d 914, 919 (5th Cir. 1995) (opposition of majority of creditors warranted denial of approval of settlement).

Not only did the Bankruptcy Court approach the facts here with an articulated bias towards approving the Settlement, it ignored the coincidence of interests between the Committee and Sun which should have triggered skepticism, rather than deference. The record here shows that the interests of the Committee and Sun were not adverse, but coincided as to the exclusion of the Drivers. The Committee's constituency, general unsecured creditors, would receive nothing under a settlement for less than the amount needed to pay the priority WARN Claims in full-a figure probably around $10 million. It was hence the paramount interest of the Committee to negotiate a deal under which the Drivers were excluded. According to its counsel, Sun's interest coincided with the Committee's because Sun did not want to fund the Drivers. The Bankruptcy Court's conclusion that the Settlement was negotiated at arm's-length is undermined by the common interests of the Committee and Sun to leave the Drivers out in the cold, and most clearly, by the Settlement itself, which did just that.

* * *

B. The Diversion of Settlement Proceeds for the Benefit of General Unsecured Creditors Violates the Code's Priority System

The Code sets forth a comprehensive system establishing the order in which claims will be paid.

E.g., 11 U.S.C. §§ 503, 506, 507, 510, 547, 726. Section 503 details the types of claims that can be paid as administrative expenses. Section 506 governs the extent to which a claim is secured. Section 507 specifies ten types of claims that will receive priority among unsecured claims and the order in which those claims are paid. These interlocking provisions are found in chapter 5 of the Code, which applies to cases under any chapter of the Code (other than 9 and 15). 11 U.S.C. § 103(a). The Settlement, by allocating proceeds of an estate asset (the LBO Action) for the benefit of general unsecured creditors, circumvents the priority system of the Code.

Courts have rejected attempts by parties to enter into pre-plan settlements in chapter 11 that circumvent the Code's priority system. In *AWECO*, 725 F.2d at 293, the Fifth Circuit reversed the district court's approval of a pre-plan settlement of litigation involving the debtor and a junior unsecured creditor. Senior creditors argued that the settlement would jeopardize their priority position by depleting estate assets. *Id.* at 298. The appellate court held that "a bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that priority of payment will be respected." *Id.* It rejected the notion that the Code's comprehensive priority system was only implicated in chapter 11 plans, explaining "[a]s soon as a debtor files a petition for relief, fair and equitable settlement of creditors' claims becomes a goal of the proceedings. The goal does not suddenly appear during the process of approving a plan of compromise." *Id.* Similarly, the Second Circuit in *Iridium*, 478 F.3d 453, held that "whether a pre-plan settlement complies with the Code's priority system is the most important, and often

the dispositive factor in determining whether the settlement is 'fair and equitable.'" *Id.* at 464.

Here, Appellees have attempted to evade the Code's priority system by causing general unsecured claims to be paid through the Settlement to the exclusion of the Drivers. That attempt, like those rejected by the Second and Fifth Circuits, cannot be sanctioned. Permitting parties who control a bankruptcy case—the DIP lenders, the debtor and the committee—to circumvent the priority system of the Code not only allows them to avoid paying the priority wage claims of laid off employees, but also has been used to deprive the United States Treasury, which is funded by taxes that constitute the other major 507 priority class. *See In re LCI Holding Co.*, 2014 WL 974145 (D. Del. Mar. 10 2014) (also now on appeal before this Court).

The Lower Courts held, however, that the priority system of the Code is not implicated and emphasized that the Settlement need not comply with the "absolute priority rule" at issue in *Armstrong*. JA-19; JA-32. In so holding, the Lower Courts conflated the absolute priority rule of 11 U.S.C. § 1129(b)(2) with the priority system of the Code. Appellants have never cited *Armstrong* for the proposition that the Settlement violates 11 U.S.C. § 1129(b)(2), but have cited that decision for the broader proposition that the priority system of the Code cannot be circumvented.

The problem is partly semantic. The words "absolute priority rule" appear nowhere in the Code. The term most often to refers to the requirement in 11 U.S.C. § 1129(b)(2)(B) that equity cannot get anything under a plan unless unsecured creditors are paid in

full.[9] That rule plainly does not apply here. The "absolute priority rule" also sometimes broadly refers to priority system of the Code which requires claims with a higher priority to be paid before lower priority claims. *E.g.*, *Iridium*, 478 F.3d at 463-64 (describing waterfall of distribution as the "absolute priority rule").

* * *

CONCLUSION

The District Court's January 24, 2014 Orders dismissing the appeal and affirming the November 28, 2012 Bankruptcy Court Order should be reversed in their entirety. This matter should be remanded to the Bankruptcy Court, which would be required to reopen the cases, to implement this Court's decision, with specific instruction to convert these cases to chapter 7 in light of Appellees' concession that no chapter 11 plan is possible.

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[9] Congress intended to codify the "absolute priority rule" in this section. Senate Report No. 95-989, 95th Cong., 2d Sess. 127-128 as reprinted in 2013 Collier Pamphlet Edition Part 1 932.

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v.

CIT GROUP/BUSINESS CREDIT, INC., in its capacity as Agent; SUN CAPITAL PARTNERS, INC.; SUN CAPITAL PARTNERS IV, LP; SUN CAPITAL PARTNERS MANAGEMENT IV, LLC.

CASIMIR CZYZEWSKI; MELVIN L. MYERS; JEFFREY OEHLERS; ARTHUR E. PERIGARD; and DANIEL C. RICHARDS, on behalf of themselves and all others similarly situated, Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE

BRIEF OF THE UNITED STATES AS AMICUS CURIAE SUPPORTING REVERSAL

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It appears that the bankruptcy court conflated section 507 with the absolute priority rule codified in section 1129(b)(2)(B)(ii). Under the absolute priority rule, general unsecured creditors may not receive distributions under a chapter 11 plan unless any objecting priority creditors' claims have been paid in full.[9] *See* 11 U.S.C. § 1129(b)(2)(B)(ii). The bankruptcy court ruled that the latter provision only applies to plans and, therefore, did not bar the settlement.

That statement misses the point. Section 507 gives the Truck Drivers an affirmative right to priority payment in chapter 11 cases. And section 507, unlike section 1129, is not limited to plans. Therefore, a settlement must comply with section 507 before the bankruptcy court can approve it. *See Espinosa*, 559 U.S. at 273-75; *In re Busy Beaver Bldg. Ctrs., Inc.*, 19 F.3d at 841.

The two circuits that have addressed the issue agree that the Code's priority scheme must be respected in pre-plan settlements, although neither decision relies specifically on section 507. Noting that the goal of fair and equitable settlement of creditors' claims appears as soon as the debtor files a petition,

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[9] Section 1129(b)(1) provides that a plan must be "fair and equitable" with respect to any class of claims unless all impaired classes have accepted the plan. 11 U.S.C. § 1129(b)(1). To be fair and equitable with respect to a class of objecting, impaired, unsecured creditors, the plan may not provide for any classes of claimants junior to the impaired, objecting class to receive any property under the plan. 11 U.S.C. § 1129(b)(2)(B)(ii). Section 1129(b)(2)(B)(ii) codifies the "absolute priority rule" that traditionally prevented the debtor from receiving property before all creditors' claims had been paid. *In re Armstrong World Indus., Inc.*, 432 F.3d 507, 512 (3d Cir. 2005).

the Fifth Circuit held that "a bankruptcy court abuses its discretion in approving a [pre-plan] settlement with a junior creditor unless the court concludes that priority of payment will be respected as to objecting senior creditors." *United States v. AWECO, Inc. (In re AWECO, Inc.)* 725 F.2d 293, 298 (5th Cir. 1984). The Second Circuit ruled that "whether a particular settlement's distribution scheme complies with the Code's priority scheme must be the most important factor for the bankruptcy court to consider" when approving a settlement. *Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452, 463 (2d Cir. 2007). Otherwise, courts could prefer junior creditors and deplete the estate through settlement, thereby depriving senior creditors of the priority to which they are entitled, and colluding parties could improperly employ settlement as a means to avoid the priority strictures of the Code.

That appears to be the case here. Chapter 11 includes detailed requirements intended to protect all of the creditors that must be followed before a plan of reorganization may be confirmed. Instead of proposing a plan that included a settlement of estate claims against CIT and Sun, which would be subject to acceptance by the creditors and confirmation by the court, the settling parties agreed to distribute the estate's assets according to their own interests in violation of the Code's priorities. It seems unlikely that the Official Committee of Unsecured Creditors would have agreed to the settlement absent the diversion of funds to its own constituency.

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TRANSCRIPTION OF HEARING BEFORE THE
THIRD CIRCUIT COURT OF APPEALS
JANUARY 14, 2015
IN RE: JEVIC HOLDING CORP., ET AL.
(DEBTORS)

Transcribed by:
Christine Aiello

Job No. J0317850

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PROCEEDINGS

(On the record)

JUDGE HARDIMAN: Good morning. First case this morning is number 14-1465, in re: Jevic Holding, committee of unsecured creditors, versus CIT Group.

Mr. Raisner.

MR. RAISNER: Thank you, Your Honor. The Appellants have requested seven minutes for themselves and of those – seven minutes for myself, five minutes for United States Government, and three minutes for rebuttal.

JUDGE HARDIMAN: Very well. Thank you.

MR. RAISNER: Jack Raisner from Outten Golden on behalf of the certified class of X employees of Jevic Holdings. Your Honors, this case, it is not simply about the elimination of a creditor's claim in bankruptcy, it's about the undermining of the checks and balances of the Bankruptcy Code and of the rule of law, itself. The class of X employees of Jevic had a $9 million wage priority claim that was deemed valid, but a coterie of powerful parties of the bankruptcy including the debtor, did not want them to have that claim.

JUDGE HARDIMAN: All right. And they, Sun's lawyer basically admitted that, they didn't want to pay a party to help fund litigation. I think we understand the facts, but what prohibits the structured dismissals?

MR. RAISNER: The structured dismissal is premised on the power of a judge to take away a property that belongs to a party, to a creditor, to eliminate it entirely. Not to just reduce its priority status, but to take it away. There is no such power

that is accorded to any judge under any rule of law just to do that.

JUDGE HARDIMAN: So you –

JUDGE SCIRICA: So the – I'm sorry.

JUDGE HARDIMAN: Go ahead.

JUDGE SCIRICA: No, no, no. So the – the bankruptcy judge said here, these are dire circumstances, but without this infusion of cash there would be no settlement and nobody would get anything, the administrative creditors would, there would be a shortfall, and there would be nothing for the unsecured creditors; so what – what does he do in that circumstance? And what, you know, and eventually tie in the remedy, but we've got a long ways to go before we get to that point.

MR. RAISNER: Sure. Your Honor, the bankruptcy judge does have the ability to balance equities and to look for expediencies and look for rational outcomes. No one doubts that, but nothing gives the bankruptcy judge to act on that and to take away someone's claim entirely in order to balance the equities or to get to some practicable result.

JUDGE BARRY: Well, he – he effectively, he – he applied the Martin factors. In fact, you're effectively arguing those here today; aren't you? And don't three of the Martin factors weigh against you if –

MR. RAISNER: Your Honor, with due respect, the argument – the Martin factors are premised on the fact that the, first of all, the Court has the power to exercise what is being asked, to give the right to assign who gets money and to take away money from another party. The Martin factors, Your Honor, are just part of the test of 9019 in a settlement.

JUDGE BARRY: Understood, but that is an ordinary settlement. You have factors here that go beyond an ordinary settlement. You have the Absolute Priority Rule not applied. You have a structured dismissal, which I suppose is an offshoot of the Absolute Priority Rule. So we don't just have simple four factors here.

MR. RAISNER: Your Honor, the Martin test alone is not the test for even an ordinary settlement. In Chapter 11, the true standard is Martin, but more importantly the Supreme Court standard in TMT Ferry, which is that the settlement be fair and equitable. The Appellees leave that out of their arguments, they leave that out of their brief. That is the central factor for any settlement in Chapter 11. And the Supreme Court in TMT Trailer Ferry said that the words fair and inequitable mean adherence to the priority code.

That was left out by the Appellees because they can't –

JUDGE HARDIMAN: Was there a –

MR. RAISNER: – meet the test.

JUDGE HARDIMAN: – confirmable plan in TMT?

MR. RAISNER: That was a 1964-case. It was prior to the 1978 Bankruptcy Code. It has been applied by courts in the Third Circuit and elsewhere to settlements, 9019 settlements in bankruptcy routinely including this Court. This –

JUDGE HARDIMAN: All right.

MR. RAISNER: – Court applies that test

JUDGE HARDIMAN: So you're –

MR. RAISNER: – plus –

JUDGE HARDIMAN: – you're – you want –

MR. RAISNER: – the Martin factors.

JUDGE HARDIMAN: You – so you want – you want an absolute rule then that a bankruptcy judge can never approve a settlement that doesn't adhere strictly to the priorities of Section 507?

JUDGE BARRY: On –

MR. RAISNER: They –

JUDGE BARRY: a per se rule.

MR. RAISNER: They, the priorities have to be looked at. The Third –

JUDGE HARDIMAN: Well–

MR. RAISNER: The – the –

JUDGE HARDIMAN: Well, looked at and adhered to are different. This bankruptcy judge looked at it. He referenced the force of the trustee's argument and said something is better than nothing, because it – and – and I – I want to back into challenging a premise that you articulated a minute ago, which is property was taken away from your clients. As I've evaluated the record, it appears that, in fact, there was no exit strategy for your clients where they would have gotten money because there's no confirmable plan, you don't challenge that, so we're, then we're going to Chapter 7 liquidation, correct?

MR. RAISNER: Your Honor, if we go to Chapter 7 liquidation, we will find out –

JUDGE HARDIMAN: Then the–

MR. RAISNER: – whether – we will find out there whether there is enough property in the estate, because property can be added to it, but –

JUDGE HARDIMAN: All right. But if we go to liquidation, now we've – we've got 1.7 million in the estate at that time, correct?

MR. RAISNER: Yes.

JUDGE HARDIMAN: Okay. And you've got CIT and Sun with $53 million in– in secured claims. So –

MR. RAISNER: There's –

JUDGE HARDIMAN: So you know, that 1.7, none of that is going to get to the drivers.

MR. RAISNER: There is a viable claim, an LBO claim against Sun and CIT.

JUDGE HARDIMAN: That the bankruptcy judge made a finding of fact that – that a lawyer would have to have his head examined if he – if he took that on a contingency. And moreover, I didn't see anything in the record that at the hearing you put forward a lawyer or two to get on the stand and testify, yes, I specialize in class actions and I do those on a contingency and I'd be happy to take this case. Why didn't you put forward any evidence of that?

MR. RAISNER: There – there needs to be an absolute rule that you cannot just wipe out someone's claim just because a judge or a witness balances equities and say this may be a better outcome than –

JUDGE BARRY: So –

MR. RAISNER: – that when – when

JUDGE BARRY: – you would like us, I would imagine, here's one right over the plate for you, to adopt the Iridium rule, the rule of Iridium in the Second Circuit that says that compliance with a priority scheme is the most important factor. Now we're talking a pre-plan settlement here and – and an

Iridium. That's different from – from a Rule 11. In a pre-plan settlement case in the context of Chapter 11, I think I said Rule 11, the most important factor and usually dispositive factor is– is compliance with, if it's fair and equitable, and the district judge has to weigh heavily, heavily the fact that the proposed settlement of – that – that the bankruptcy court, I'm not – you can only vary in minor respects –

MR. RAISNER: That –

JUDGE BARRY: – from the Absolute Priority Rule. And that is the clear and certain rule of Iridium. And the other factors have to weigh heavily in favor of the settlement, it was a pre-plan settlement; and the bankruptcy court has to her – hear from the proponent good and sufficient reasons why there should be a variation from the Absolute Priority Rule in that context.

MR. RAISNER: Correct, Your Honor. Iridium was building toward the plan. And even then, the Court said, even if – if there is a deviance from the priority rule in the most minor respect, the whole settlement has to be denied. Here we are not moving to a settlement. These Appellees are racing to the exit. They are trying to scoop up whatever they can, getting releases from the Court. Getting the rule – right to appoint who gets what, take away the claim of someone who they don't like. They want to get all of –

JUDGE HARDIMAN: Well, your – your clients didn't lose their claim. They – they still have their WARN Act claim intact.

MR. RAISNER: Not against the estate. They lost any –

JUDGE HARDIMAN: The –

MR. RAISNER: – value.

JUDGE HARDIMAN: – the estate had nothing. It was a carcass. It was – it was so far –

MR. RAISNER: That's a –

JUDGE HARDIMAN: – underwater.

MR. RAISNER: – that's a valuation judgment. If we had, if –

JUDGE HARDIMAN: It's a valuation judgment that I don't think I'm capable of making, but the district court is surely, excuse me, the bankruptcy judge is capable of making it. And the bankruptcy judge told this, the district court and this Court that there's nothing here. So why, how – what – what grounds do we have to –

MR. RAISNER: A –

JUDGE HARDIMAN: – upset that factual claim?

MR. RAISNER: Congress leaves that decision to the Chapter 7 –

JUDGE BARRY: Well –

MR. RAISNER: – trustee.

JUDGE BARRY: – of course the Chapter 7, the only real case cited by the bankruptcy court was Armstrong, and – and that was a Chapter 11 case and it wasn't a pre-plan settlement case.

MR. RAISNER: And this Court adhered to the priority scheme. Iridium did so as well with respect to the leftover money that might be left in the case, that money –

JUDGE BARRY: What are the differences –

MR. RAISNER: – had to be –

JUDGE BARRY: – between Iridium though, and – and Armstrong? Is that, the Second Circuit viewed a variation in that context, the pre-plan settlement context, to be of enormous importance. And here it was just – just another factor –

MR. RAISNER: This is of no importance.

JUDGE BARRY: – before the bankruptcy court.

MR. RAISNER: This is of no importance. It's – it's – it's to accommodate the –

JUDGE BARRY: Yeah.

MR. RAISNER: – parties who ask for this –

JUDGE SCIRICA: So – so –

MR. RAISNER: – who are well heeled. The Court felt – excuse me, but I'm sorry – I'm sorry, just real quick.

JUDGE SCIRICA: No, no, go ahead and finish – finish your thought.

MR. RAISNER: The Court found also on page 23 of the brief that these are well-heeled people. They have the ability, if they wanted, to confirm a plan or to observe the priorities, they just didn't want to. The bankruptcy judge should not have dignified that, not wanting –

JUDGE SCIRICA: So –

MR. RAISNER: – to do things –

JUDGE SCIRICA: So we are

MR. RAISNER: – and let them go; it should have said, you should do it. The fact that you have chosen not to fund these things means that this must go to a Chapter 7 trustee who will decide whether there's value here or not. They cannot just make a clean – a

clear break for the exit and take with them their releases which only come when a plan is confirmed. It doesn't even come to them in a Chapter 7.

They got the rewards of confirming a plan without doing anything, with doing the reverse, with, walking away from all the responsibilities and the checks and balances and yet they have their cake and eat it, too.

JUDGE SCIRICA: Well –

MR. RAISNER: I'm sorry, Judge Scirica.

JUDGE SCIRICA: – what is – what is the remedy if we, assuming we – we thought your – you – you should prevail here, we go to Chapter 7; is that it?

MR. RAISNER: Correct, because that is the option that –

JUDGE SCIRICA: And that –

MR. RAISNER: – congress – the congress –

JUDGE SCIRICA: And that's – and that's it, nothing more?

MR. RAISNER: We – we, if – if we undo the settlement and we go to Chapter 7, we're following the code. If there is –

JUDGE HARDIMAN: And then what happens if –

JUDGE SCIRICA: So you're not asking for any remedy from us other than it goes to Chapter 7?

MR. RAISNER: Correct.

JUDGE SCIRICA: You're not asking for disgorgement?

MR. RAISNER: I think that –

JUDGE SCIRICA: You're not asking for reforming the plan. Is – is that correct?

MR. RAISNER: Correct.

JUDGE BARRY: Okay. And I have –

JUDGE HARDIMAN: And then – and then just briefly play out for us what – what you would expect to happen when it goes to Chapter 7.

MR. RAISNER: The Chapter 7 trustee will take a look at it, will do, make a judgment. We believe that there are Chapter 7 trustees who the Appellees did not want this case to go to, and so they found a way to get it away from – from a judgment of an independent. They put on evidence, it's true, but to have in evidence –

JUDGE HARDIMAN: And the Chapter 7 trustee will take the 1.7 million and – and do what with it?

MR. RAISNER: Well, if the – if the settlement is undone, the – the – the property should be returned to the estate that was improperly distributed. So to –

JUDGE HARDIMAN: Right.

MR. RAISNER: – that extent –

JUDGE HARDIMAN: The 1,000 – the 1,029 checks get – get sent back –

MR. RAISNER: Correct.

COURT 1: – to the estate. And that, and there are a series of administrative expenses associated with that, correct?

MR. RAISNER: I would –

JUDGE HARDIMAN: How much is that, would you estimate that to cost?

MR. RAISNER: I'm not certain, Your Honor.

JUDGE HARDIMAN: More than $100,000 in lawyers' fees, accountants' fees?

MR. RAISNER: Perhaps around.

JUDGE HARDIMAN: Postage.

MR. RAISNER: Perhaps around that, Your Honor. I'm not –

JUDGE HARDIMAN: Okay.

MR. RAISNER: – sure.

JUDGE HARDIMAN: So now we're down to 1.6 million, and then what happens to that – that money, it goes to the secured creditors, right?

MR. RAISNER: If that's the rules, then that is the rule, yes.

JUDGE HARDIMAN: And the drivers still get nothing?

MR. RAISNER: Correct. If – if there's nothing left in the estate.

JUDGE HARDIMAN: Right.

MR. RAISNER: But it should be under – it – it –

JUDGE BARRY: See, that's –

MR. RAISNER: Yeah.

JUDGE BARRY: – my, one of my problems with this case, that we could write an opinion giving guidance for future cases where we end up talking about Iridium and things of that nature, and we could send it back and we could ask the bankruptcy judge and the district court to take a look at it under, you know, the guidance we give in this opinion; but I think what I hear you saying is that at the end of the day the result will be the same.

MR. RAISNER: It may be, Your Honor. It's difficult for us to try to recreate in some kind of ad hoc way what should be done under the code. We think it's the better advice to let the code do its job, because that puts pressure on Appellees, on people in bankruptcy to face a Chapter 7 trust – problem and do something about it, like putting money into the estate or not, and that's up to them.

JUDGE BARRY: All right.

JUDGE RAISNER: And that is what causes settlements, that's what causes the system to –

JUDGE BARRY: And – and –

MR. RAISNER: – work.

JUDGE BARRY: – I guess –

MR. RAISNER: If we take it apart – I'm sorry.

JUDGE BARRY: This is –

MR. RAISNER: Yeah, go ahead.

JUDGE BARRY: This is one of, this would be one of those ugly results I think that the trustee referred to that one has to – one has to apply the code, the priority rule of the code even though on occasion there may be a docketing result.

MR. RAISNER: Correct, because in the larger picture, the fact that parties in bankruptcy face the cliff of Chapter 7 if they don't apply the code, creates mischief. And we, as plaintiffs, as – as creditors, cannot chase the mischief. We do not have the funds. We do not have the ability –

JUDGE BARRY: Uh-huh.

MR. RAISNER: – to rethink the code and be a step ahead of everyone else.

JUDGE HARDIMAN: All right, thank you, Mr. Raisner.

JUDGE SCIRICA: Yes.

JUDGE HARDIMAN: Oh, go ahead.

JUDGE SCIRICA: I'm sorry, just one quick question.

And is – is it correct that you did not want to participate in the settlement or you were completely barred from it?

MR. RAISNER: There was no evidence –

JUDGE SCIRICA: Engaging in that.

MR. RAISNER: – as to what happened, Judge Scirica, but the truth is that we were told that we had to give up our claims against Sun Capital against –

JUDGE SCIRICA: The WARN claim?

MR. RAISNER: – everybody – against everybody as

JUDGE SCIRICA: Yeah.

MR. RAISNER: – the price of admission to have our bankruptcy claim be accorded its value to participate. That is not a requirement that someone has to pay to be a creditor in bankruptcy, to give up claims against other people outside of the bankruptcy sphere, that's –

JUDGE SCIRICA: All right.

MR. RAISNER: – on – that's – that's – we – we participated to the extent that that was a (inaudible) type of take it or leave it.

JUDGE HARDIMAN: Okay, thank you, Mr. Raisner. And we'll see you on rebuttal.

MR. RAISNER: Thank you.

JUDGE HARDIMAN: Ms. Cox.

MS. COX: Good morning. May it please the Court, I'm Wendy Cox, I'm with the Department of Justice and I represent the amicus, the United States of America in this case. The United States briefed two issues in this case, just two, the equitable mootness issue and the issue of whether the bankruptcy court may confirm a settlement that does not – that distributes assets in a way that does not comply with the code's priority scheme.

The United States is prepared to stand on its brief with respect the equitable mootness issue unless there are any questions.

JUDGE SCIRICA: I should have asked Mr. Raisner why he didn't seek a stay, but no, I have no questions at the moment here.

MS. COX: Okay. Then – then –

JUDGE HARDIMAN: I – I – you put that first, I found that curious, you inverted the arguments. Is that a sign that the equitable mootness argument is of more concern institutionally to the office, your office, than the other argument?

MS. COX: Well, I think they're both of great concern to our office, but the equitable mootness argument is – is of great concern to our – to our office. We've – we've made that argument, we've made an argument we've tried to get that argument before the Supreme Court, but they haven't –

JUDGE HARDIMAN: Uh-huh.

MS. COX: – taken it before. We really feel that if the equitable mootness doctrine is – is expanded in any way, shape, or form; it not only deprives the Appellants

of their – of their rights to appeal, their statutory rights to appeal, but it also has the effect, particularly in bankruptcy, of really strangling the development of binding Appellant precedent on important, and here you can see recurrent, bankruptcy issues. And –

JUDGE BARRY: Well, our sen prude (phonetic) opinion just of 2013 made it very clear how rare it will be that equitable mootness will – will prevail as an issue. And you know, it – it – it was very, very strong.

MS. COX: Absolutely we – we agree. And perhaps that's another reason for putting it first is that it seemed to be, it seemed – there seemed to be a very clear answer that – that this Court's precedent has made it clear that it – that it only applies –

JUDGE HARDIMAN: To confirmed plans.

MS. COX: – to –

JUDGE HARDIMAN: Yeah.

MS. COX: – substantially –

JUDGE HARDIMAN: Okay.

MS. COX: – consummated confirmed plans.

JUDGE HARDIMAN: All right. Well, let's – let' s

MS. COX: Okay.

JUDGE HARDIMAN: – focus on the –

MS. COX: So – so –

JUDGE HARDIMAN: – other issue.

MS. COX: – turning to the –

JUDGE HARDIMAN: Let –

MS. COX: – merits.

JUDGE HARDIMAN: Let me ask you a question on the merits and maybe guide your argument, but we'll

hear whatever you care to tell us, the code doesn't prohibit structure dismissals, but nor does it explicitly authorize them. So does this case come down to who has the burden here?

MS. COX: Well, okay, I apologize, we – we, the Government, did not take a position on structured dismissals. We had a very tailored –

JUDGE HARDIMAN: Well, but I'm –

MS. COX: – amicus brief.

JUDGE HARDIMAN: – asking your position now, which is –

MS. COX: Well, I – I – I – I – I – can't – I have to have authority from the solicitor general to address issues on behalf of the United States.

JUDGE BARRY: But –

MS. COX: It has to be approved.

JUDGE BARRY: – you've been active all over the country, at the U.S. Trustee's office in – in – in objective settlements that violate the – the Absolute Priority Rule and structured –

MS. COX: And –

JUDGE BARRY: – dismissals as I understand it.

MS. COX: Well, as – as – as amicus, we felt that we were only able to raise a limited number of issues, we had a very, you know, we were restricted in what we could raise, so we – so we – we raised what we believed to be –

JUDGE HARDIMAN: But you didn't appeal –

MS. COX: – the most, the strongest –

JUDGE HARDIMAN: You didn't –

MS. COX: – and most –

JUDGE HARDIMAN: You didn't appeal to the district court, right, that's why you're amicus –

MS. COX: In – in this case.

JUDGE HARDIMAN: – here – right.

MS. COX: In this case. We –

JUDGE HARDIMAN: So – so –

MS. COX: – did not – we did not –

JUDGE HARDIMAN: – I guess we should take that as – as a signal that – that your office was okay with what the bankruptcy –

MS. COX: No, no.

JUDGE HARDIMAN: – court did here.

MS. COX: I strongly disagree – disagree with –

JUDGE HARDIMAN: Well, then why didn't –

MS. COX: – that.

JUDGE HARDIMAN: But you didn't appeal.

MS. COX: The reason, we have very good reason for not appealing, we, it was really a question of prosecutorial discretion. We didn't appeal because we had a very similar case raising substantially identical issues before the same court at – at the same time.

JUDGE BARRY: Don't you have to get permission to appeal an issue? Wouldn't you –

MS. COX: Not at the district court level.

JUDGE BARRY: Not at the district –

MS. COX: No.

JUDGE BARRY: – court level?

MS. COX: No.

JUDGE BARRY: Okay.

MS. COX: Okay. So –

JUDGE BARRY: What about to us?

MS. COX: To –

JUDGE BARRY: With –

MS. COX: Yes.

JUDGE BARRY: But you haven't appealed it to us because you didn't –

MS. COX: Well, we also have to get –

JUDGE HARDIMAN: Had no stay.

MS. COX: – permission from (inaudible) to appear as amicus –

JUDGE HARDIMAN: (Inaudible).

MS. COX: – to – to appear as amicus before your Court.

JUDGE BARRY: Okay.

MS. COX: So – so our argument actually is – is very straight forward based on the text of the code. So as – as this Court permits, the – the creditors' committee was litigating estate claims on behalf of the estate, that the claims didn't belong to the creditors committee, they didn't belong to any of the individual creditors. So – so when it settled those claims, the proceeds of the settlement had to come into the estate. And when they came into the estate, if they were to be distributed, they had to be distributed in accordance with the code's priorities. Now the –

JUDGE HARDIMAN: Where does the code say that? Where does the – where does the code say that when parties in a Chapter 11 case reach a settlement,

the proceeds of that settlement must be distributed according to Section 507?

MS. COX: The code doesn't say that expressly, but it doesn't have to because Section 507 says that – that certain claims will have priority. They have priority in payment of – of when estate assets are distributed. And so –

JUDGE HARDIMAN: So you're saying that the 3.7 million had to be assiduously distributed in accordance with Section 507?

MS. COX: It – it was – it became – yes,

yes.

JUDGE HARDIMAN: Okay. Then –

MS. COX: It –

JUDGE HARDIMAN: – in this bankruptcy, who are the most senior creditors?

MS. COX: The most senior creditors, well, in the – the – there were –

JUDGE HARDIMAN: And the prior –

MS. COX: – secured creditors.

JUDGE HARDIMAN: Let's go through the –

MS. COX: There are secured creditors –

JUDGE HARDIMAN: – priority –

MS. COX: – and then – and then there were –

JUDGE HARDIMAN: Go through the ten priorities.

MS. COX: – priority creditors.

JUDGE HARDIMAN: So the secured – so the secureds are the top of the – of the food chain here, correct?

MS. COX: But they gave up their right to those, they gave up the right, their incumbrances, their liens on that money in return for the estate giving up its claims against them, for giving them releases. There was – there was, you know, a tit for tat. It was consideration to the estate for something that the estate gave up. So the money became the estate's money, and then it had to be distributed, it – it couldn't be distributed to – to creditors with no priority when creditors with, that were guaranteed priority by Section 507 were getting nothing.

I – I – and that's not something that's subject to equitable considerations. That's not – the code, that's clear from the code, that Section 103 says that Section 507 that – that those – that Section 507 applies in Chapter 11. And Section 507 sets out specific priorities for distribution of estate assets, not – that the court was not at, the bankruptcy court was not at liberty to –

JUDGE HARDIMAN: But if it's –

MS. COX: – apply equities to –

JUDGE HARDIMAN: – if it's so clear –

MS. COX: – ignore that.

JUDGE HARDIMAN: – then why – why would the – the creditors' committee counsel approve this settlement then? I mean –

MS. COX: Well, I – well, I –

JUDGE HARDIMAN: Are you saying it was a breach of fiduciary duty even to arrange a settlement of this nature? Do you –

MS. COX: I think there was sort of an undue focus or – or a conflation between Section 1129, which sets out a somewhat different Absolute Priority Rule as – as

– as it applies to plans. And they looked at that and they said, you know, if they said, well, 1129 only applies to plans, it doesn't apply to –

JUDGE BARRY: What do you want –

MS. COX: – to settlements.

JUDGE BARRY: – us to do? I mean, you're not appealing here because you can't. You're an amicus, but what – what do you want or what do you, the U.S. Trustee of the United States Department of Justice –

MS. COX: We –

JUDGE BARRY: – want us to do?

MS. COX: We would like you to reverse the order approving a settlement that – that violates express code provisions and – and send a signal to parties that they can't – they can't basically, you know, administer and distribute assets and do everything through a settlement and then say, well, these code protections don't apply because it's a settlement and –

JUDGE HARDIMAN: All right. But then what happens –

MS. COX: – not a plan.

JUDGE HARDIMAN: – as a practical matter here in this case?

JUDGE BARRY: Well, I think – I don't think we know for certain. I think that, you know, the case would be remanded back to the bankruptcy court, and then the parties would –

JUDGE HARDIMAN: And then it goes to a 7.

MS. COX: – maybe – it might go to a 7.

JUDGE HARDIMAN: Why –

MS. COX: It might –

JUDGE HARDIMAN: Why would you say –

MS. COX: It might be dismissed.

JUDGE HARDIMAN: – it might? What did the bankruptcy judge find about that?

MS. COX: The bankruptcy judge found that the – that, right, that the case would not likely go to a 7, it wouldn't be feasible in a 7. So the –

JUDGE BARRY: Well, nobody would take anything.

JUDGE HARDIMAN: The bankruptcy court found, as a matter of fact, there's no confirmable plan –

JUDGE BARRY: Yeah.

JUDGE HARDIMAN: – it's going to a 7, there's – there's $1.7 million that the trustee in the 7 has, and that that 1.7, and there's, and that 1.7 million is secured by the 50-plus million dollars in – in secured creditors. So that there's no money to fund – the only reason asset of the estate, correct me if I'm wrong, is the chosen action to pursue the LBO litigation, right?

MS. COX: Right.

JUDGE HARDIMAN: And the bankruptcy judge found, as a matter of fact, that that wasn't a viable claim; but even if it were a viable claim, there was no money to prosecute that claim. So what, then what happens?

MS. COX: Well, I don't –

JUDGE HARDIMAN: Are you – are you suggesting that any of those findings by the bankruptcy judge are clearly erroneous?

MS. COX: No, but I – I don't think that equities matter where the – where the – where the statute is clear.

JUDGE HARDIMAN: They're not equities. These are facts. These are factual findings.

MS. COX: Well, they're fact–

JUDGE HARDIMAN: Are they – are they – are they clearly erroneous fact findings or –

MS. COX: We're not arguing that the fact – that the – that the factual findings are clearly erroneous, what we're arguing is that where the code clearly prohibited – prohibits what was done in this settlement, there's, the only way to, you know –

JUDGE HARDIMAN: Okay.

MS. COX: – the only way to deviate is if the code, itself, expressly –

JUDGE HARDIMAN: So we're –

MS. COX: – provides some –

JUDGE HARDIMAN: – we're –

MS. COX: – authorization –

JUDGE HARDIMAN: So we're back–

MS. COX: – to deviate.

JUDGE HARDIMAN: – to a black letter rule of law, a very straight forward holding that says, structured dismissals are not allowed unless they adhere in an exacting way to the priorities listed in Section 507?

MS. COX: Well, I would say perhaps not – not structured dismissals, per se, because as I say, we didn't quite go that far in our brief, but distributions,

yes, distributions of – of estate assets can't be allowed in settlements unless they –

JUDGE HARDIMAN: So there–

MS. COX: – comply with the –

JUDGE HARDIMAN: – can never be –

MS. COX: – code's priority –

JUDGE HARDIMAN: – a settlement – there can never be a settlement then that doesn't adhere strictly to the 507 priorities?

MS. COX: Correct.

JUDGE HARDIMAN: Okay.

JUDGE BARRY: Okay. (Inaudible).

MS. COX: Thank you.

JUDGE HARDIMAN: Thank you, Ms. Cox.

Mr. Landau.

MR. LANDAU: Thank you, Your Honor, may it please the Court, I'm Chris Landau and I'm here this morning on behalf of the Appellees. I'd like to start with the point that Judge Scirica made or asked, the question that Judge Scirica asked to my opposing counsel, what on earth was the bankruptcy court supposed to do given these concededly unusual circumstances and then pick up on the point that Judge Hardiman just made, which is, there's three points here that are really undisputed that you take as a given, the – the factual findings that are not seriously contested.

First, there was no confirmable plan in Chapter 11. Second, conversion to a 7 was not a feasible option because that was a long shot claim and no lawyer would have taken it on contingency. So it would have

happened upon conversion to a 7, it was a short order, distribution of all the money to the secured creditors, Sun and CIT, and the WARN claimants would have wound up with nothing in that alternative scenario. The court had a hearing –

JUDGE SCIRICA: Why not –

MR. LANDAU: – on this.

JUDGE SCIRICA: Why not go through – why not go through that process?

MR. LANDAU: Well, Your Honor, again as the court decided, the court had a hearing on this, and if there were some potential merit in that process, the court then, you know, that was the subject of the hearing, Your Honor. And the court decided, I think, quite reasonably on this record that, you know, he – he actually had a comment, you know, what would the trustee do if I dumped this case on – on him or her with no lawyer, no money to fund the litigation and just said, here, you –

JUDGE SCIRICA: All right. But –

MR. LANDAU: – deal with this.

JUDGE SCIRICA: – just because it might make no economic sense doesn't mean it's not required under the law.

MR. LANDAU: Well, that's correct, Your Honor. And so –

JUDGE SCIRICA: And –

MR. LANDAU: – then –

JUDGE SCIRICA: And you've got this – this dicta from the Supreme Court that's – that's supportive of their position; isn't it?

MR. LANDAU: I – i disagree with that, Your Honor. I mean, it seems to me, going back to the TMT Trailer Ferry case in the '60s, it is quite clear that the code does not speak to settlements. The code doesn't say, in settlements, this and that will happen. That was the issue in – in TMT trailers in the late '60s, how do you deal, what is the criteria for evaluating a settlement under the Bankruptcy Code. And the code doesn't speak to this, so the Supreme Court said you have to look at kind of equitable factors. That's what this circuit has called the Martin factors, those equitable factors.

Now under the Government's view that the code specifically speaks to that, the Martin factors go out the window because there is no Martin equitable balancing. There is no looking at the claim that was given up. You've just got to apply the code in a mechanical fashion.

JUDGE BARRY: Well, let me ask you a very basic question. Why was this case filed under Chapter 11 in the first place? Chapter 11 as you well know is entitled reorganization, but in May, what is it, 2008, when it was filed, Jevic was already well into winding down. They'd already terminated 1800 truck drivers. Why – it was well on its way to liquidation before it even filed in May 2008; wasn't it?

MR. LANDAU: Yes, Your Honor. I asked that exact same question when I got into the case, and the –

JUDGE BARRY: It's a –

MR. LANDAU: – answer –

JUDGE BARRY: – good question.

MR. LANDAU: Well, yeah, it's a good question, it's a very good question.

JUDGE BARRY: Thank you.

MR. LANDAU: I – I – and the answer, Your Honor, is, that was given to me by my bankruptcy colleagues who do this day in and day out, is that – that you want to preserve, you want to maximize the value to the estate under the code and that they have found that doing a Chapter 11 maximizes value as opposed to going the 7 liquidation route. And liquidation is a viable option under Chapter 11. You can have a plan of liquidation under Section 1123 and it's actually apparently, this somewhat came as a surprise to me given the title of the chapter that you just read, Your Honor, there is, you know, Chapter 11, plans of reorganization, apparently are not that uncommon.

And I did some looking online and I found that courts, you know, the Second Circuit just recently dealt with equitable mootness in the context of a Chapter 11 plan of liquidation. So that's the, I mean, I think that's – that's the answer that was –

JUDGE BARRY: But – but –

MR. LANDAU: – given to me that –

JUDGE BARRY: But –

MR. LANDAU: – this was foreseen as the better route.

JUDGE BARRY: – when – when the parties appeared in November 12th before the bankruptcy court to approve the settlement, at that point there was no prospect of a confirmable plan?

MR. LANDAU: Correct. That's, and there's a factual finding. And I – I don't believe that that's disputed here today before you.

JUDGE BARRY: No, I understand that. I just don't know why, when it became clear at the very outset, in my view, that this was not really a reorganization, that Chapter 7 wasn't filed –

MR. LANDAU: You're –

JUDGE BARRY: – as soon as it became clear that plan could not be confirmed.

MR. LANDAU: Your Honor, again, I – I am giving you the – the – the pragmatic answer that I was given about maximizing value. And again, that specific issue about filing under Chapter 11 in the first instance has never been raised as a point of error in these proceedings. In other words, as these proceedings arrive here, we take the case as it comes, which is it was a Chapter 11 case. And so you know again, the alternatives were a Chapter 11 plan, everybody agrees that's off the table, Chapter 7 conversion. And – and there's – I think and that was –

JUDGE HARDIMAN: Right. But there's another – there's another alternative. Why wouldn't it have been more fair and equitable and more consummate with the structure of the Bankruptcy Code to require the following; take the $3.7 million and distribute it to the tax creditors, to the 1,029 trade creditors, you know, low priority creditors, and to the drivers –

MR. LANDAU: Oh, but –

JUDGE HARDIMAN: – in some sort of, you know, pro rata –

MR. LANDAU: Right, that was the –

JUDGE HARDIMAN: – distribution in accordance with their relative positions under 507?

MR. LANDAU: Right, that was the third point that I was going to make. In other words, the three kind of predicates here are no Chapter 11 confirmation, no Chapter 11 plan, no Chapter 7 liquidation that would be feasible, and no better settlement because as I think –

JUDGE HARDIMAN: There – there was a better settlement, it's just that CIT and Sun were insisting that the drivers get nothing unless they give up their WARN Act –

MR. LANDAU: Well, this –

JUDGE HARDIMAN: – claim.

MR. LANDAU: Again, the way a settlement works, everybody gives and takes a little bit. And the Sun and – and the – the drivers, again, this, there was some colloquy earlier about did they participate, they kind of said, oh, well, we were shut out; there's factual findings in both the district court and the bankruptcy court that that's not true, they were not shut out, they participated in negotiations, but ultimately decided, which is their right, that they don't want to cut a deal –

JUDGE SCIRICA: I thought that –

MR. LANDAU: – like other priority creditors did.

JUDGE SCIRICA: Yeah, I thought the charge was that they wouldn't have contributed any money unless the WARN people were shut out.

MR. LANDAU: No. They – no, no, no. That's – that's not the charge. The charge, Your Honor, was they would not have agreed to a settlement that funded the WARN plaintiffs if the WARN plaintiffs were going to continue to litigate against Sun.

JUDGE HARDIMAN: All right. And the WARN action is over, you won.

MR. LANDAU: Well, no, but Sun, but –

JUDGE HARDIMAN: So why don't –

MR. LANDAU: – no, if that –

JUDGE HARDIMAN: – we remand – why don't we remand it for some sort of –

MR. LANDAU: Well –

JUDGE HARDIMAN: – affirmation of the settlement –

MR. LANDAU: Let me say at the time –

JUDGE HARDIMAN: – that – that now puts some money in the drivers' pockets in accordance with their priority?

MR. LANDAU: Well, Your Honor, again, you are reviewing a settlement that was entered into before we won that. That – that was decided subsequently, and that appeal is pending before this Court right now. It was just recently filed, and we just got a briefing schedule, I think, last week. And so that – that appeal is not over yet, but again you have, what you are reviewing is whether the bankruptcy judge abused his discretion in approving the settlement under the facts as he knew them –

JUDGE SCIRICA: The – the facts –

MR. LANDAU: – at the time.

JUDGE SCIRICA: – were or the main fact in was these were dire circumstances.

MR. LANDAU: Exactly.

JUDGE SCIRICA: Well, yes, but question, couldn't it be argued that CIT and Sun created the very circumstances that led the bankruptcy judge to that conclusion because they sold all the property, they sold everything?

MR. LANDAU: Well, Your Honor, again –

JUDGE SCIRICA: Everything was –

MR. LANDAU: – the – the –

JUDGE SCIRICA: – sold.

MR. LANDAU: But nobody is saying that anything, they did anything wrongful here. That's not a –

JUDGE SCIRICA: Well, I mean, maybe it's not wrongful, but there's a smell test; isn't there? I mean, in a way and then, you know, I mean, you know, I don't know.

MR. LANDAU: But –

JUDGE SCIRICA: I mean, they – it – because of what they did, we are in dire circumstances.

MR. LANDAU: Well, and, Your Honor, that – that, but that goes to the question that was presented to the bankruptcy court in the first instance in applying the Martin factors. If the Martin – if – if somebody says, look, there's something fishy going on here, that's very important under the Martin factors. The bankruptcy court didn't find that anybody did something –

JUDGE SCIRICA: Well, I am, I'm just asking the question. It's –

MR. LANDAU: No, no, fair enough.

JUDGE SCIRICA: – just an innocent question.

MR. LANDAU: No, no, fair – fair enough, Your Honor. And I – I'm sorry if I –

JUDGE SCIRICA: Well, how did they get to this point where the circumstances were –

MR. LANDAU: Well, I think –

JUDGE SCIRICA: – dire?

MR. LANDAU: – that they were –

JUDGE SCIRICA: Why –

MR. LANDAU: They –

JUDGE SCIRICA: Why was there no money left?

MR. LANDAU: Well, because they had a very secured creditor, that they had CIT, which had the top security; and when a lot of the assets of the debtor were being liquidated and – and sold off, that money went to CIT. That money would not have gone to the WARN plaintiffs anyway. Again that's just the way the system works, that – that – that, you know, the people with the most security are – are the first in line.

And – and let me make one point absolutely clear, we have no quarrel with the general approach of the Iridium case. It seems to me the Iridium case in the Second Circuit is actually fully consistent with what happened here.

JUDGE SCIRICA: That was followed here.

MR. LANDAU: I – I believe it was followed, yes, Your Honor, because what – what –

JUDGE BARRY: (Inaudible).

MR. LANDAU: Well, Your Honor, I mean, the – the Iridium Court says in, you know, in all but exceptional circumstances that – that you – you have to follow, you – you have to give weight in the Martin factor analysis. And you know, we – we may not go quite as far as Iridium saying, you know, it's usually, it's – it's very

heavy weight; but we don't disagree with the general notion.

JUDGE BARRY: It said the most important factor and in most cases –

MR. LANDAU: Right.

JUDGE BARRY: – the dispositive factor –

JUDGE HARDIMAN: Uh-huh.

JUDGE BARRY: – is noncompliance with the absolute provider – priority rule – scheme. And it – it says, only when the remaining factors weigh heavily –

MR. LANDAU: Yes.

JUDGE SCIRICA: – in favor of settlement.

MR. LANDAU: And – and I think here with –

JUDGE HARDIMAN: You're not –

JUDGE SCIRICA: And –

JUDGE HARDIMAN: – trying to upset that –

JUDGE SCIRICA: And the –

JUDGE HARDIMAN: – standard?

JUDGE SCIRICA: – absolute –

MR. LANDAU: No.

JUDGE SCIRICA: – priority violation is a very minor violation, only then, only then will the settlement be approved.

MR. LANDAU: Well, Your Honor, I'm – I'm not sure about where – where it says minor. Does – does it say –

JUDGE SCIRICA: It does.

MR. LANDAU: Okay.

JUDGE SCIRICA: To endorse the settlement if in some minor –

MR. LANDAU: Okay.

JUDGE SCIRICA: – respects it does not comply with the Absolute Priority Rule. If the parties justify – justify it and the court clearly states it reasons for –

MR. LANDAU: Right.

JUDGE SCIRICA: – deviation. I don't see any-clear statement here if you say you don't have any problem with Iridium –

MR. LANDAU: Well, again –

JUDGE SCIRICA: – that the bankruptcy judge has done that.

MR. LANDAU: Put it this way, Your Honor, I mean, I don't necessarily want to say every last word in that statement that Your Honor just read. I said – the point I was trying to make is the more general point that the Government here and the other side to an extent is making a perfectly valid general or raising a perfectly valid concern that you don't want a system, you don't want to create the possibility for abuse when you have a settlement that in a way re-jiggers things, that you then move on to a plan, in a sense the settlement has monkeyed with the priority factors that would then have to be followed in the plan.

I think what is critical in this case is that this was not a settlement that was a precursor to a plan because there's a finding here that no confirmable plan was –

JUDGE HARDIMAN: All right.

MR. LANDAU: – possible.

JUDGE HARDIMAN: That – that – that might be significant, but isn't it even more significant that the court, the bankruptcy court found that the drivers weren't going to receive anything anyway?

MR. LANDAU: Yes.

JUDGE HARDIMAN: All right. So then – then what I hear you saying is you don't challenge the Second Circuit's standard that priorities are the most important consideration, often dispositive, and only in exceptional cases should this be allowed. You're saying, here we are with the exceptional case –

MR. LANDAU: Correct.

JUDGE HARDIMAN: – and the bankruptcy judge so found.

MR. LANDAU: Correct.

JUDGE HARDIMAN: All right. But the question then becomes, what's the rule, you know, how – how did – how should that be articulated. And I mean –

JUDGE SCIRICA: We open the door to sub rosa plans.

JUDGE HARDIMAN: Right, well –

MR. LANDAU: Well, I think you do. And – and I think that's – that's a legitimate concern, we agree, but again a sub rosa plan presupposes in a sense that you are using the settlement as a way to evade the requirements for a plan.

JUDGE HARDIMAN: Yeah.

MR. LANDAU: You can't have a sub rosa plan if there was no ultimate plan that you were circumventing or trying to evade. I think that's the point. In other words, there's no evasion under these cases. I think what Your Honors can – it's a little bit hard to have I think a one-size-fits-all absolute rule here. I think that's a little –

JUDGE BARRY: That's why I asked the – the smell test question about, this really never was a Chapter 11. I mean, this was a liquidation from the outset, from the filing.

MR. LANDAU: But even if it were a liquidation, you would still have to, you could have a settlement in Chapter 7.

JUDGE BARRY: Wouldn't – no – yeah, wouldn't it have gone to Chapter 7 right away? I mean, it didn't.

MR. LANDAU: Again – again, you know, for whatever reason, Your Honor, it – it didn't, and so we're – we're in this world. And again we're in the Martin factor world. There is a threshold legal issue which the Government has teed up, which is does the priority system of 507 apply to settlements as a matter of law. We submit that the answer to that clean legal question is no, that going back to Martin and –

JUDGE HARDIMAN: No wait, wait.

MR. LANDAU: – the TMT.

JUDGE HARDIMAN: They – they apply, they're just not mandated.

MR. LANDAU: Well, fair enough, Your Honor, right, I –

JUDGE HARDIMAN: Because – because –

MR. LANDAU: – that's what I meant, Your Honor.

JUDGE HARDIMAN: – if I'm a bankruptcy judge, the first thing I'm going to look at–

MR. LANDAU: Yes.

JUDGE HARDIMAN: – is how does this settlement sitting on my desk fit in the scheme of the priority.

MR. LANDAU: You're absolutely correct, Your Honor. And I – I'm sorry if that was not clear. What I meant to say is – is the application of the priority system mandatory in the context of settlements like it is in the context of plan confirmations under 1129 in the Chapter 11 context or in liquidations under 726, Section 726 in the Chapter 7 context.

JUDGE HARDIMAN: So should we adopt a rule –

MR. LANDAU: The answer to that is –

JUDGE HARDIMAN: Should we adopt a rule then that says the extraordinary circumstances have to be so extra ordinary that the factfinder, the bankruptcy judge, has to determine that the creditors who are being skipped, here the drivers, would have received nothing? So in other words –

JUDGE SCIRICA: Yeah.

JUDGE HARDIMAN: – the – the – it's a – it's a no harm, no foul rule.

JUDGE BARRY: It's a plain error.

MR. LANDAU: Yeah.

JUDGE HARDIMAN: It's a – right, that – that by – by preferring these low level trade creditors –

MR. LANDAU: Right.

JUDGE HARDIMAN: – we haven't taken a penny out of the pocket of the creditors who were prior to them.

MR. LANDAU: Right. I don't know that –

JUDGE HARDIMAN: Should that –

MR. LANDAU: – Your Honor –

JUDGE HARDIMAN: – be the rule?

MR. LANDAU: I don't know that you need to say never, that you always must have that situation, but here where you have that situation, I think there's no question that – that it's okay. In other words, I think you are marking out one send of the spectrum with this case where, in fact, what you just said is true. Whether or not this is the only circumstance you would apply it, I don't know that you should, you need to or – or should in this case announce the rule that is broader than that.

That's obviously the way the opinion gets – gets written. I think it is – it is hard to imagine many scenarios when you have a scenario where somebody, actually there is some possibility for recovery from then when it's possible to bypass the code. I guess I, you know, it's – it's – it's hard to think about all of the possible scenarios. I mean, bankruptcies come in so many different shapes and –

JUDGE BARRY: Well, there was a contested –

MR. LANDAU: – sizes.

JUDGE BARRY: It was contested back then. It's not as if – as if there was – there was – they were contesting it, you know.

MR. LANDAU: Absolutely. Well, yeah, I mean, but they – but again –

JUDGE BARRY: I mean, it's not as if it were all the parties agreed to a settlement.

MR. LANDAU: No, they – they were –

JUDGE BARRY: Not that –

MR. LANDAU: That's – that's fair, but I mean, they – but then they went to – there was a hearing, exactly as Your Honor said, on November 13, 2012,

everybody came into the bankruptcy court and there was a hearing and there were witnesses and there was cross-examination. And look, what would really happen. And I think this goes back to a point you raised, Judge Scirica, like what would, you know, what would be the harm of just sending it to Chapter 7? Wouldn't that kind of make it go well with the code?

Well, the court found there would be significant, you know, significant, you would continue to deplete the estate, you would dump something on the trustee; and the court at some point has to make a finding of what's likely to happen. And – and Chief Judge Shannon is a very seasoned bankruptcy practitioner and I think he made a very reasonable finding under these circumstances that, you know, something, these folks in a sense are only acting as spoilers because they're not going to get any better off.

The WARN plaintiffs aren't going to come out any better. All they're going to do is prevent the distribution that allows – that – that hurts other unsecured creditors who actually get something out of the –

JUDGE HARDIMAN: They're – they're –

MR. LANDAU: – settlement.

JUDGE HARDIMAN: – paying it forward to future drivers or people in the – in similarly situated, that's sort of, right?

MR. LANDAU: I mean, you know.

JUDGE HARDIMAN: I mean, it still might be an important principle of law to establish even if the drivers don't get it.

MR. LANDAU: Right, but again I think, you know, it seems to me once you – the important legal question here is really the one that the Government presents, and I think they are just wrong as a matter of law to say that – that – that the – the code operates the same with respect to settlements, that the 507 factors by their terms, the Section 507 priorities, excuse me, by their term apply rigidly to settlements and a settlement must apply those factors.

That's inconsistent with the law going back to the TMT case in the Supreme Court. Once you're out of there, then you're in Martin factor land.

JUDGE HARDIMAN: Well, but – but wait a minute.

MR. LANDAU: And –

JUDGE HARDIMAN: Wait a minute. Because in TMT, I'm going to quote what the Supreme Court said there, the requirement that plans of reorganization be both fair and equitable applies to compromise, just as to other aspects of organizations. This standard, the fair and equitable standard, incorporates the absolute priority doctrine under which creditors and stockholders may participate only in accordance with their respective priorities.

MR. LANDAU: Well, again, Your Honor, the –

JUDGE HARDIMAN: How do you get around that?

MR. LANDAU: Well, the way that has been played out, and certainly in this Court's Martin factor, and again, it can incorporate that and we don't deny that in applying the Martin factors, in applying the equitable standard, the priority rule is a very, important consideration. Again, I think that makes sense. You

don't want to have settlements being done as a way to evade the priority system. Totally fair point. You don't want to open the door to abuse, but that doesn't mean that the priority system rigidly applies ipso facto by its own terms in the context of a settlement. You have a more equitable discretion.

And that's why the Martin factors don't say, you – the first thing you do is you apply the code no matter what. The – the code – the – excuse me, the priorities are not even in the Martin factors as they're articulated, although we think it is certainly fair as – as other courts have done to say, as part of looking at the interest of the creditors under the fourth factor of Martin, it's very important to – to understand why there is any deviation from the priority system and to justify that.

And I think it's fair to say there should be a pretty heavy burden of justification. I just think under any circumstances that burden was satisfied in this particular case.

JUDGE SCIRICA: Let me ask you about equitable mootness. Am I correct in assuming that it's not essential to your argument that the district judge didn't have to use that or – or is it an integral part of your argument?

MR. LANDAU: It's not essential, Your Honor. It's an alternative ground to say, look, I think these folks are right on the merits, and – and the appeal will be affirmed on the merits. In the alternative I would find that this is equitably moot. Primarily I think this goes back to a point Judge Barry raised before, and maybe she'll ask counsel on rebuttal, why they didn't seek a stay. To this day they have never explained why they didn't seek a stay.

JUDGE SCIRICA: Well –

MR. LANDAU: But so anyway the short answer to your question is we don't rely on equitable mootness. We think it provides an alternative ground, and we think this is a fairly compelling case for equitable –
JUDGE SCIRICA: Even – even though it –

MR. LANDAU: – mootness. does not involve a confirmation of the plan?

MR. LANDAU: Yes, Your Honor. And in fact, and I'm glad you raised that, because one case we, in preparing for this argument, a very recent case just came out from the Second Circuit, which canvasses the equitable mootness doctrine as applied to liquidations as opposed to just confirmed plans. And it's the BGI case at 772 F.3d 102 and the discussion is at page 109. And again, that came out after the briefing of this case was concluded, but that case applies equitable mootness to a, actually a Chapter 11 liquidation proceeding and said – and says in the course of that, that equitable mootness has also been applied in the context of Chapter 7 liquidations.

It's not only – I mean, certainly the considerations underlying equitable mootness are very relevant in a Chapter 7 confirmed plan.

JUDGE SCIRICA: Yeah, but our –

MR. LANDAU: But they're not limited only to that context.

JUDGE SCIRICA: But our Third Circuit law on equitable mootness doesn't – doesn't support that principle.

MR. LANDAU: Well, Your Honor, no, Your Honor, with respect I don't know that the third, that this

Court has actually specifically crossed that bridge in – in this one, I think it was an unpublished decision, Othonosios (phonetic), that the other side cited, there was a footnote that says it is questionable whether equitable mootness applies in the context of liquidations under Chapter 7, but we haven't yet reached that issue.

JUDGE HARDIMAN: So on the – on the merits – on the merits you're telling us then that the fact that there's not a confirmed plan makes all the difference, but on equitable mootness you're saying to disregard that?

MR. LANDAU: Well, Your Honor, I mean –

JUDGE BARRY: Well, can you seriously argue, and you don't, you – you weren't going to mention that, I think, with reason; and my reason that I suggest is that the district court dealt with it in one paragraph, one paragraph.

MR. LANDAU: Right.

JUDGE BARRY: No case citation, no cites to any of that, just a one-paragraph conclusion.

MR. LANDAU: Yes. I mean, we –

JUDGE BARRY: And that is not the way an equitable mootness should be treated.

MR. LANDAU: Your Honor, again, we – going back to my answer to – to Judge Scirica, we do not rely, equitable mootness is not critical to our prevailing here. We think we have very strong arguments that this was correct on the merits and that – that – that again, under the unusual circumstances of this case, the bankruptcy court acted well within its discretion in approving the settlement.

JUDGE HARDIMAN: All right.

MR. LANDAU: If there's no further questions, thank you.

JUDGE HARDIMAN: Thank you, Mr. Landau. Rebuttal, Mr. Raisner?

MR. RAISNER: Thank you, Your Honors. Your Honors' questions ripped back the veil and disclosed what is actually going on here. My colleague said he looked online for the answer to why this case did not convert that Judge Barry asked, but every bankruptcy practitioner knows why, a fourth option was invented to allow for this escape within a structured dismissal. It is to have what's called a soft landing for Sun Capital, for CIT, and for those financiers.

They don't want to be sued for the things that they did that led to the fact that this company had nothing in its coffers. They don't want the claim to go forward that met the requirements of a motion to dismiss that accused them –

JUDGE HARDIMAN: But they didn't –

MR. RAISNER: – of –

JUDGE HARDIMAN: – get a soft landing on the WARN Act. I mean, that, your clients, you know, vigorously prosecuted –

MR. RAISNER: That's what –

JUDGE HARDIMAN: – that. It's – it's still being vigorously –

MR. RAISNER: They asked –

JUDGE HARDIMAN: – prosecuted.

MR. RAISNER: – for it, and we –

JUDGE HARDIMAN: They didn't get it.

MR. RAISNER: Because we stood up to the threat, but it's –

JUDGE HARDIMAN: Right.

MR. RAISNER: – been used –

JUDGE HARDIMAN: So – so you're –

MR. RAISNER: – against us.

JUDGE HARDIMAN: – you're –

MR. RAISNER: It's been used against –

JUDGE HARDIMAN: So you're –

MR. RAISNER: – us.

JUDGE HARDIMAN: – not prejudiced. You're – you're – you're going full bore with your WARN Act claims and maybe you'll get a big recovery.

MR. RAISNER: We are prejudiced in every bankruptcy where we're told by the financiers, give up your WARN claims outside of this case or you're getting nothing in this bankruptcy. That is now the – the – the threat to us. And it's been used, base on this case, and it will be used throughout the country –

JUDGE HARDIMAN: And that's – that's –

MR. RAISNER: – to intimidate –

JUDGE HARDIMAN: That's why the structured dismissal is a source of debate about whether congress should do something about it one way or the other or –

MR. RAISNER: Absolutely.

JUDGE HARDIMAN: – give some guidance. Right.

MR. RAISNER: The whole checks and balances of the bankruptcy structure forces the – to confirm a plan or go to the 7, that's where you're going to get your hard landing. To create a soft landing induces private

equity and financiers to do whatever they want with the company knowing that as long as they deplete all the coffers and go into bankruptcy, then the judge will say, well, I guess the structured dismissal for the tip that you leave the creditors' committee is a –

JUDGE HARDIMAN: All right. But –

MR. RAISNER: – good idea.

JUDGE HARDIMAN: All right. But let me give you a counterfactual, what if the bankruptcy judge had found that the LBO case had some real merit to it? And – and I assume for that case to have had merit, that would mean that Sun and/or CIT did some things wrong in conjunction with the LBO and the financing of the business, right?

MR. RAISNER: He made the finding that a – it was –a motion to dismiss was brought, hard fought, and found that this met the standards for such claims. They were viable claims. So the –

JUDGE HARDIMAN: Yeah, and then he –

MR. RAISNER: – the only ruling is that –

JUDGE HARDIMAN: – but then he later – you –

MR. RAISNER: – there was a viable claim, Your Honor.

JUDGE HARDIMAN: But he – he – well, he – he – it was viable in passing a motion to dismiss, but then he later found, he – he, I think he used the phrase, a lawyer who would take this case on a contingency would have to have his head examined.

MR. RAISNER: That's an economic decision of a contingency lawyer and –

JUDGE HARDIMAN: And you –

MR. RAISNER: – that's a–

JUDGE HARDIMAN: – could –

MR. RAISNER: – prediction.

JUDGE HARDIMAN: You could have, right, and I know, you know, I don't want to beat you up on this, hindsight is 20/20, but it wouldn't have been too difficult to put a couple of contingent fee plaintiffs' lawyers on the stand in the hearing. You had an opportunity to be heard, and that was the time to tell this bankruptcy judge, do not be fooled, this LBO action is worth something, so don't sell us out on the cheap here because this action is really worth something. And here are a couple of lawyers who are going to explain to you how much it's worth.

MR. RAISNER: Like the million dollar bond to have taken the equitable mootness to the next level of a stay. To impose on a –

JUDGE HARDIMAN: Uh-huh.

MR. RAISNER: – creditor in a bankruptcy who doesn't have the lawyers paid by the estate, to compete on the stand to prove why they should not lose in their claim, a structured dismissal is imposing too much.

JUDGE HARDIMAN: You know what –

JUDGE SCIRICA: I'm not available – I'm sorry.

JUDGE HARDIMAN: Go ahead.

JUDGE SCIRICA: No, no. How much significance do we give to the fact that the debtor in possession financing order gave standing to litigate this issue? Is that –

MR. RAISNER: It's still the – it's still the complaint of the estate, it's the property of the estate, that claim.

The proceeds from the settlement rule the property of the estate. Is – is that Your – Your Honor's question?

JUDGE SCIRICA: Yeah, I mean, I – it – it seems to have some significance, but I don't know how far it extends.

MR. RAISNER: To the extent of – which conclusion, Your Honor?

JUDGE SCIRICA: Well, supporting your position.

MR. RAISNER: Oh, well, it supports the position that this is not a gifting manner. The – the basis of the bankruptcy and district courts' decisions in this case were based on something called gifting, not the arguments that have been brought here. These are heard for the first time, those gifting arguments basically have, were – were disposed of and a new set of arguments have been presented. I don't say they're waived, there – there should be a waiver here, but I think we properly understood that – that this was not a gifting case and we litigated that and we seemed to have achieved that. We –

JUDGE SCIRICA: Did you answer the stay issue, the stay argument?

MR. RAISNER: We – we brought the stay in the first instance, and we lost it. We didn't bring it on to the district court –

JUDGE BARRY: You lost it in the – you –

MR. RAISNER: because of the – of the

JUDGE BARRY: You –

MR. RAISNER: – the bond was –

JUDGE BARRY: Well, you brought it –

MR. RAISNER: – a million dollars.

JUDGE BARRY: – you brought it in the bankruptcy court, you didn't –

MR. RAISNER: Yes, we brought it and –

JUDGE BARRY: – bring it in the district court.

MR. RAISNER: – it was denied. So we – we were unable to obtain it, just like the six big cases that since, it's continental that, have been all allowed to be – be appealed without an equitable mootness, in not one of those cases was a stay obtained.

JUDGE BARRY: Well, you didn't bring it in the district court. You didn't seek a stay in the district court.

MR. RAISNER: That's right, because –

JUDGE HARDIMAN: (Inaudible).

MR. RAISNER: – we didn't have the means to do that.

JUDGE BARRY: Yeah.

MR. RAISNER: – we didn't have the means to do that.

JUDGE BARRY: Well, that – that was the reason, I just, my question would have been, had I asked it, why didn't you. I mean, you just answered it.

MR. RAISNER: It's –

JUDGE BARRY: How –

MR. RAISNER: – oppressive and it would – it would have been fugal.

JUDGE BARRY: Right. What – what do you want us to do? I mean, I've heard a lot of argument and you've been wonderful and I'm – I'm sorry if I gave

people a hard time, but just at the end of all of this, what – what – what is the relief you are seeking here?

MR. RAISNER: Your Honors, we are simple folks, this case should go to a Chapter 7 trustee. We can't undo the fact that there isn't a nice landing for anyone there. That was all preordained by the secured creditors in this case. So we – it's not – we – this is not the case for us to be able to figure out how closely should a settlement, should a structured dismissal hug the shoreline of the Bankruptcy Code for it to be valid. We just know that it is too oppressive and expensive and impossible for us to design such a system safely.

Because once you have a rule, the professionals will find a way to engineer around it. So it's better to have the rules as they were written by congress, how they have been applied and have been effective enforcing parties to do everything possible to avoid a Chapter 7. And if they go into a Chapter 7, the trustee will take over. That puts the pressure on the parties to do the right things, accomplish the goals that congress set forward.

It makes this code work, it makes for a stable rule, set of rules that people can count on and negotiate against in bankruptcy, otherwise we have opened a Pandora's box of chaos, and we know who is going to win in that battle. Thank you –

JUDGE HARDIMAN: Thank you –

MR. RAISNER: – very much.

JUDGE HARDIMAN: – Mr. Raisner. The panel is grateful to counsel for both sides for the truly outstanding briefing and – and argument. Thank you. We'll take the matter under advisement.

(Off the record)

STATE OF WASHINGTON)

) SS:

COUNTY OF WHATCOM)

I, CHRISTINE M. AIELLO, do hereby certify that I transcribed the audio, and that the foregoing is a true and complete transcription of the audio transcribed under my personal direction.

IN WITNESS WHEREOF, I do hereunto set my hand and seal at Blaine, Washington, this 21st day of March, 2016.

Christine M. Aiello